

# MITEF Forecasters Luncheon

January 2017

BBVA Research USA

# Key messages

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Uncertainty to remain high in 2017 as geopolitical tensions shift abroad and emerging markets deal with protectionism, financial and fiscal imbalances and lower global liquidity

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Domestic economy on solid footing and nearing equilibrium levels after investment slump in 2016

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High degree of uncertainty over magnitude, mix and timing of Trump agenda

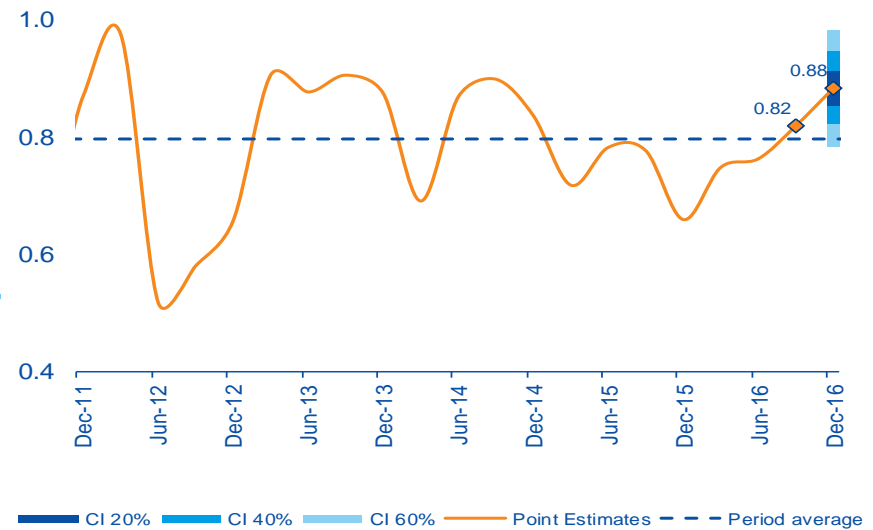
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Despite concerns of the length of the current cycle pro-growth policies and renewed optimism suggests upside to growth in next administration

# 2017: Certain about the uncertain

- 1 Populism to remain on the ballot. Will EU give rebuke to rising tide?
- 2 Global growth drivers and supportive policies will keep 2017 growth above 3%
- 3 Higher commodity prices and stronger U.S. growth to support recovery in EM
- 4 Risks Brexit, European elections, dissolution of EU, Chinese imbalances, protectionism, geopolitical conflict

World GDP, QoQ%



Source: BBVA Research

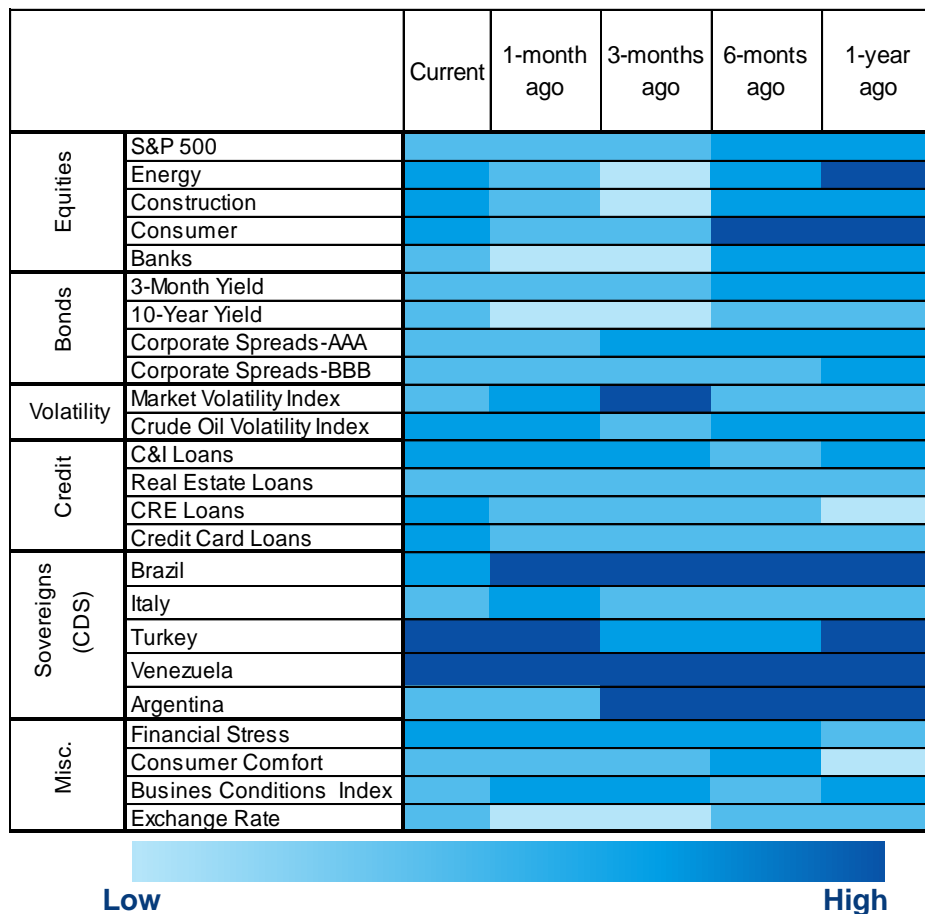
GDP growth, current forecasts\*

Unchanged   
 Upward Review   
 Downward Review

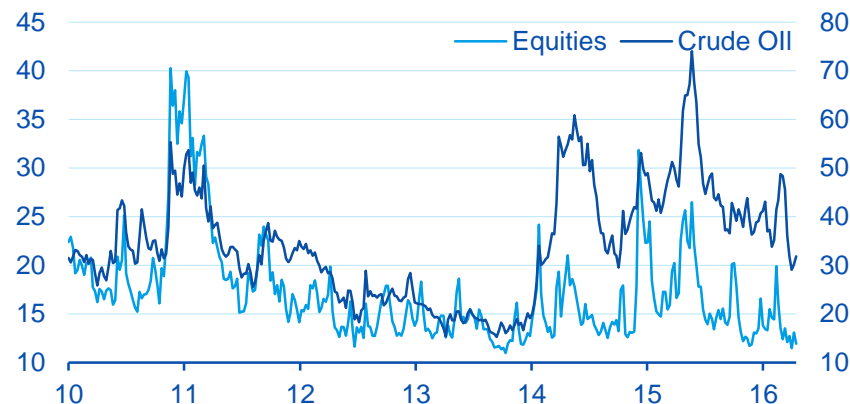
	US	EMU	Spain	Mex	LATAm-5			Turkey	China	Em. Asia
					Arg	Brazil	Andean			
2015	2.6	1.9	3.2	2.5	2.5	-3.9	2.2	4.0	6.9	6.6
2016	1.6	1.6	3.3	1.8	-2.0	-3.0	2.3	2.3	6.6	6.5
2017	2.3	1.5	2.5	2.2	3.2	0.9	2.2	3.0	5.8	6.0

# Financial markets

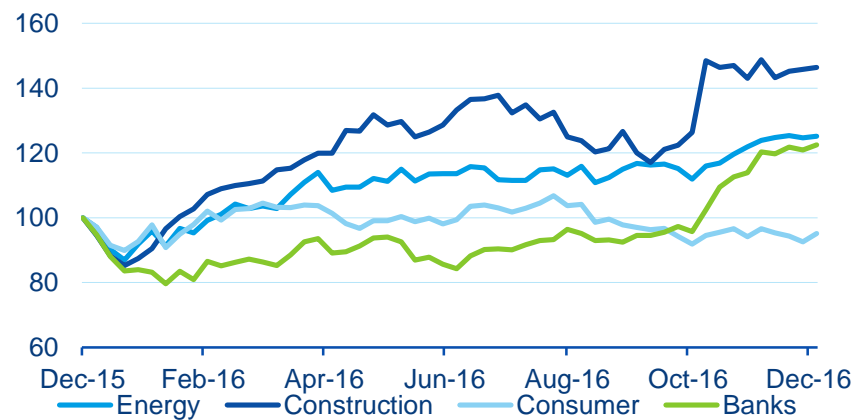
## Market Risk Indicators



## CBOE Market Volatility,%



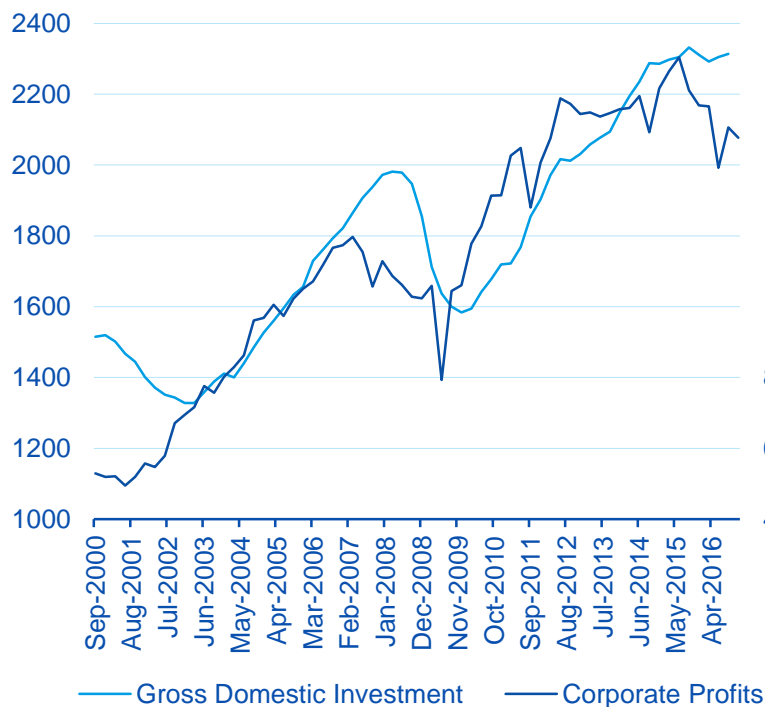
## SP Equity Indexes, Jan-2016=100



# Investment slump fading

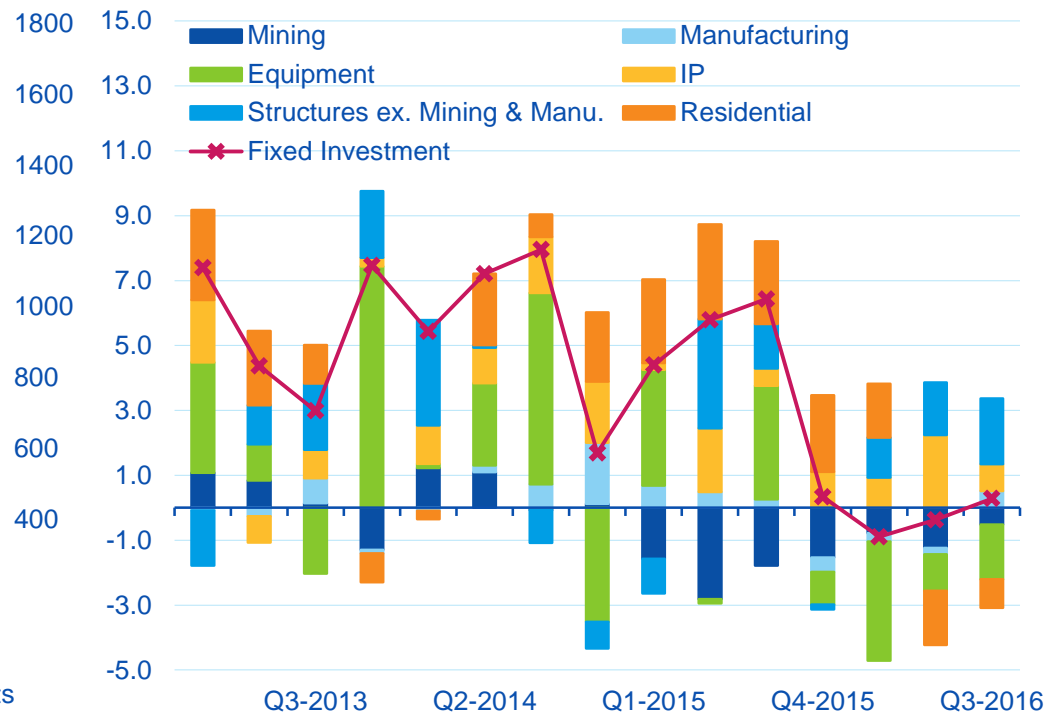
Weak corporate balance sheets, credit constraints and uncertainty dampen investment in '16

**Nonfinancial Corporate Profits & Gross Private Domestic Investment\*, Billions \$**



**Real Private Fixed Investment**

+/- s.d.

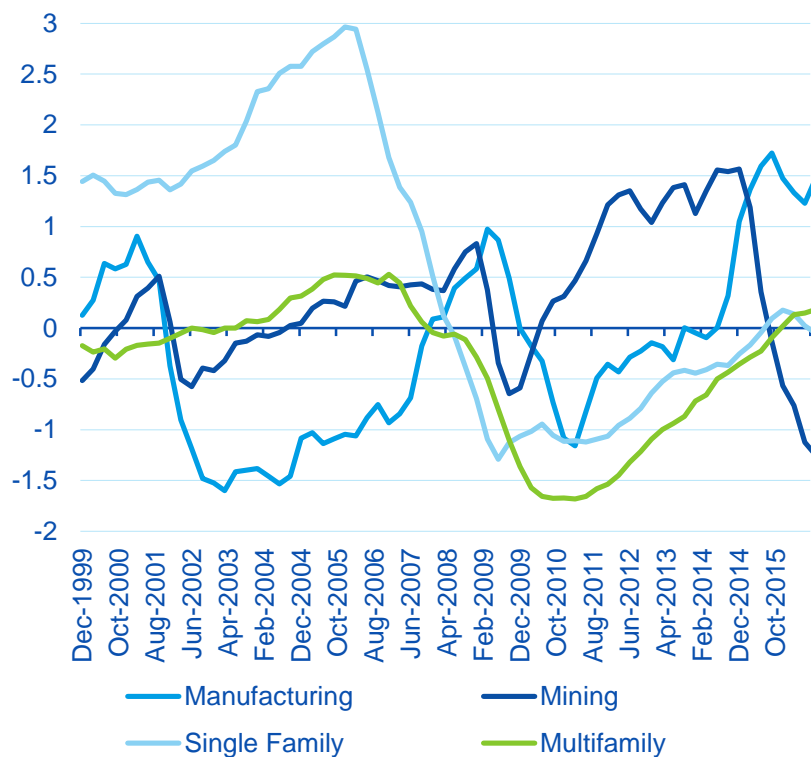


Source: BBVA Research, BEA & Haver Analytics

# Finding the next investment cycle

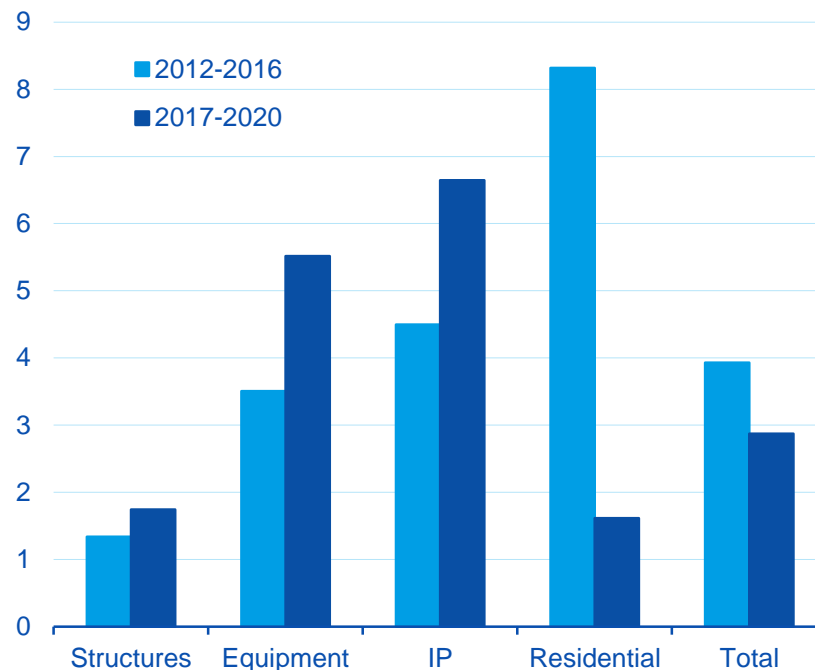
Single family and multifamily investment cycle in line with historical averages; mining sector correcting.

**Real Private Fixed Investment**  
+/- s.d.



**Private Fixed Investment Forecasts**

Average year-over-year, %

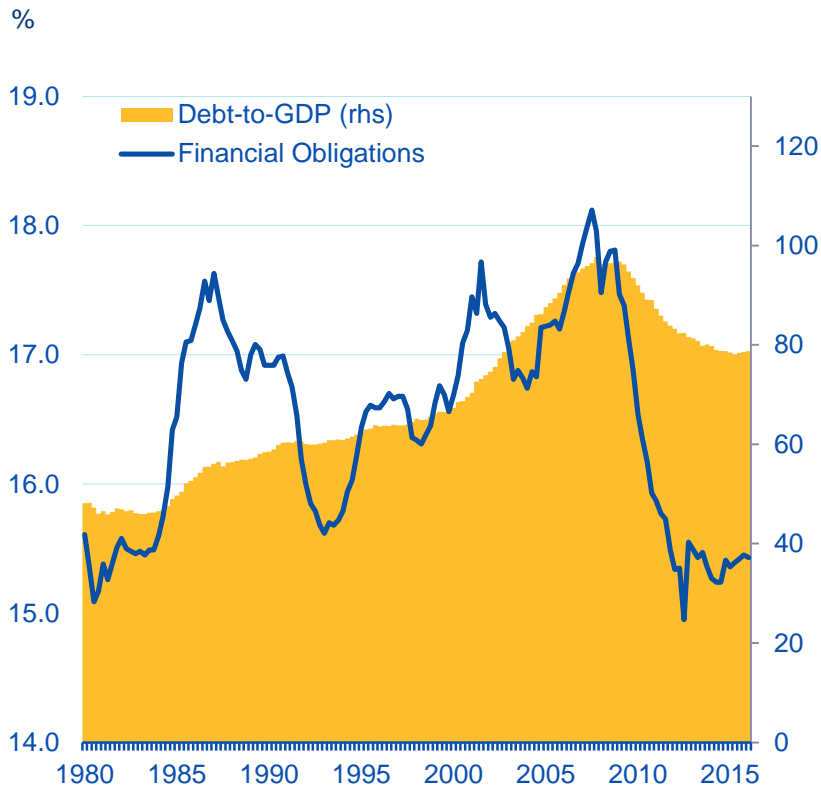


Source: BBVA Research, BEA & Haver Analytics

# Consumer on solid footing

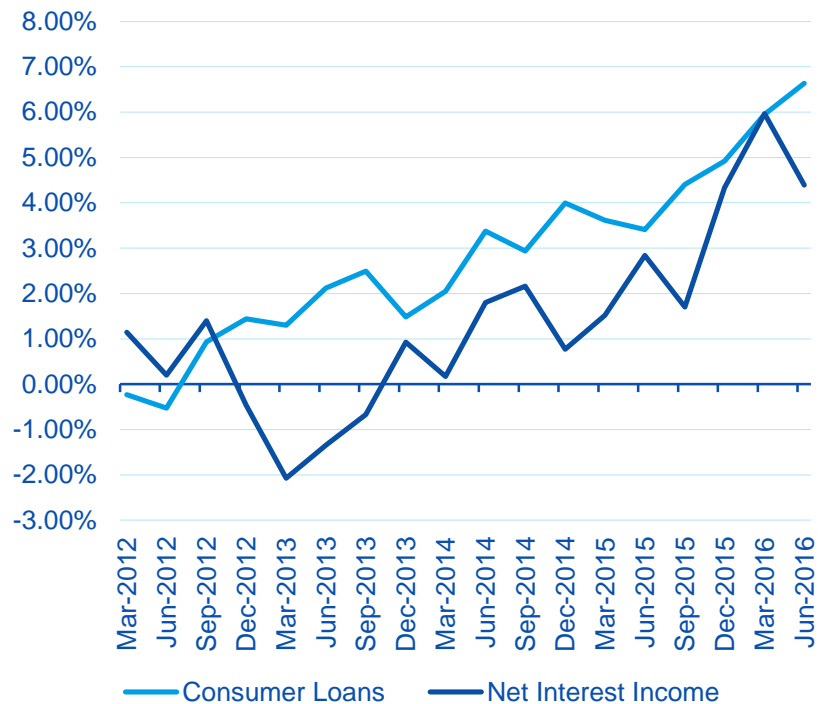
Long household deleverage cycle and strong supply-side credit conditions supporting consumption rebound

**HH Debt-to-GDP & Financial Obligations**



**Banks' Income & Consumer Loans,**

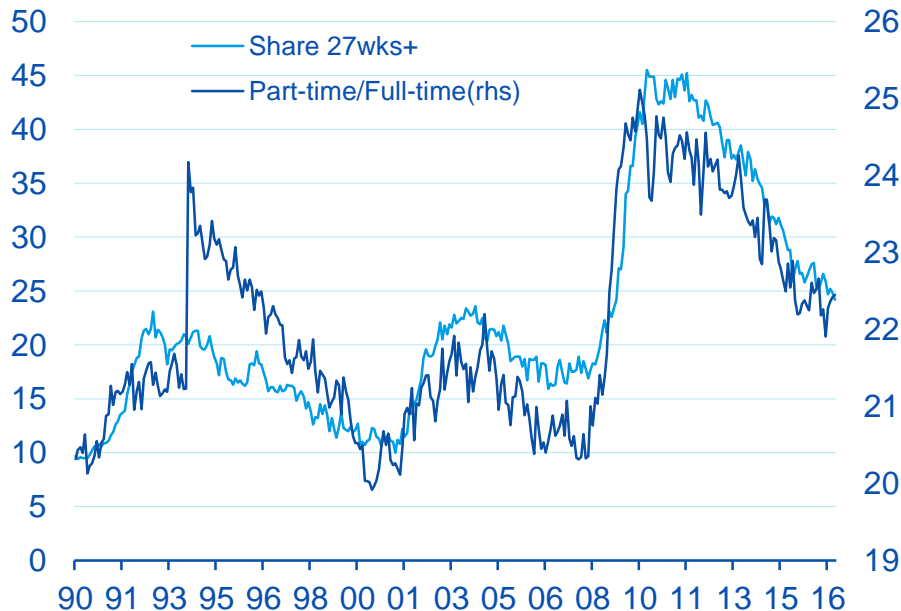
Year-over-year %



# Labor Markets

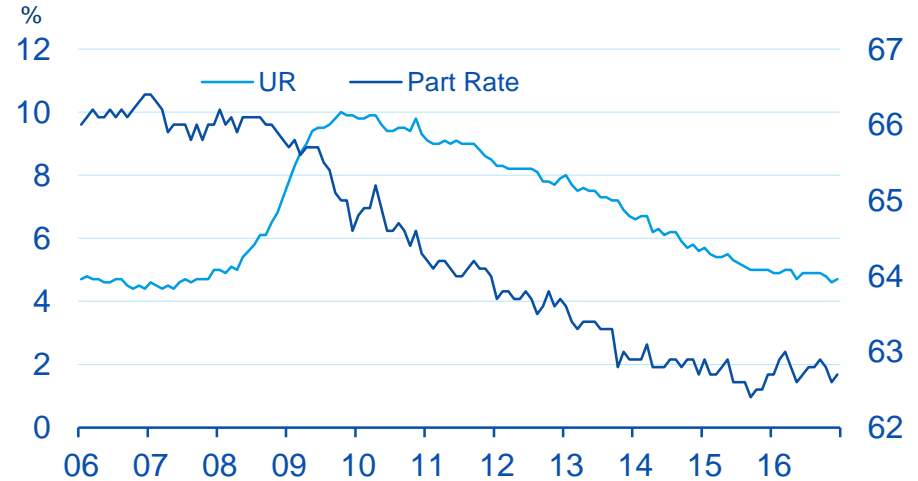
Conflicting labor force indicators generate noise around full employment and remaining economic slack debate

## Part time/full time & Long-term Unemployment



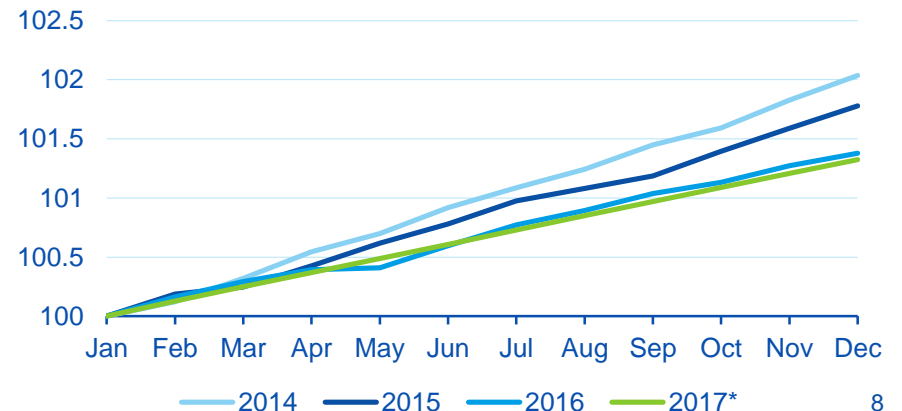
Source: BBVA Research & Haver

## Unemployment and Participation Rate



## Nonfarm Payrolls

Cumulative % change, Index to January



\*Figure based on 2017 payroll forecast

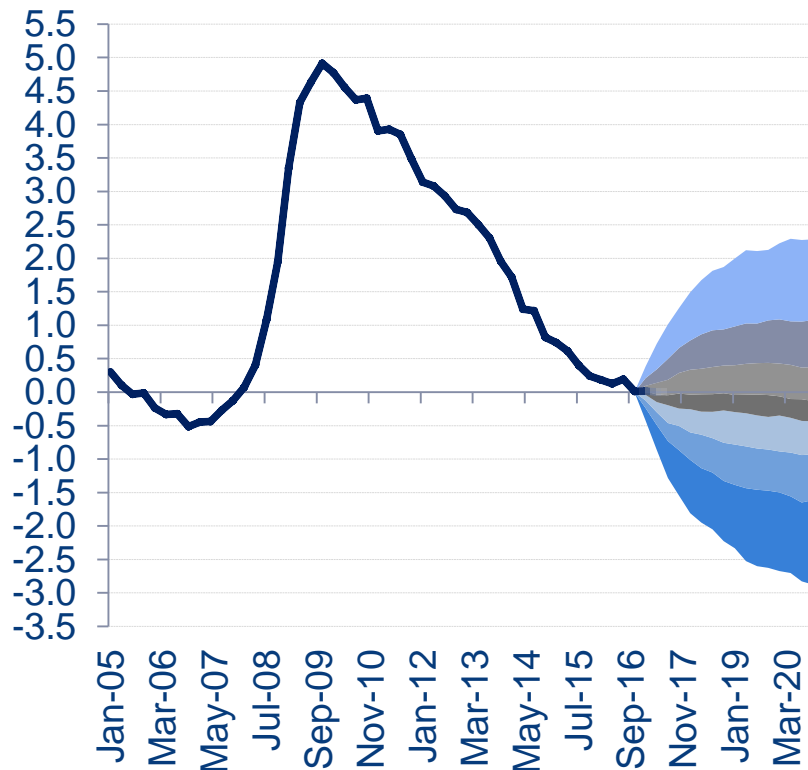


# Labor market at full employment

Boosting employment above current trend (~1.5%) could risk a significant undershooting NAIRU

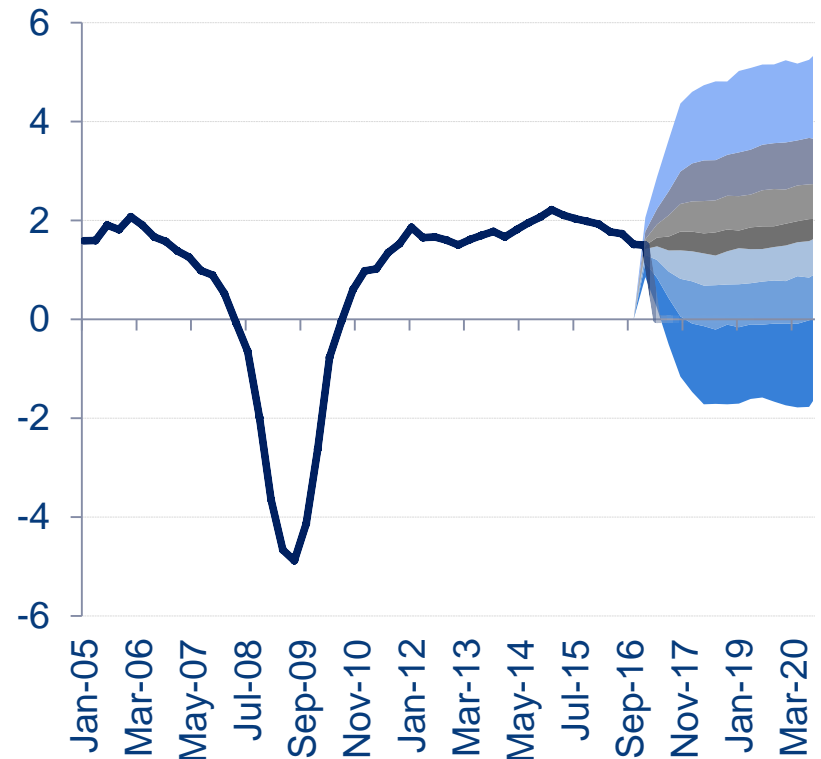
**Unemployment Rate Gap**

UR-NAIRU



**Employment Growth**

Year-over-year %

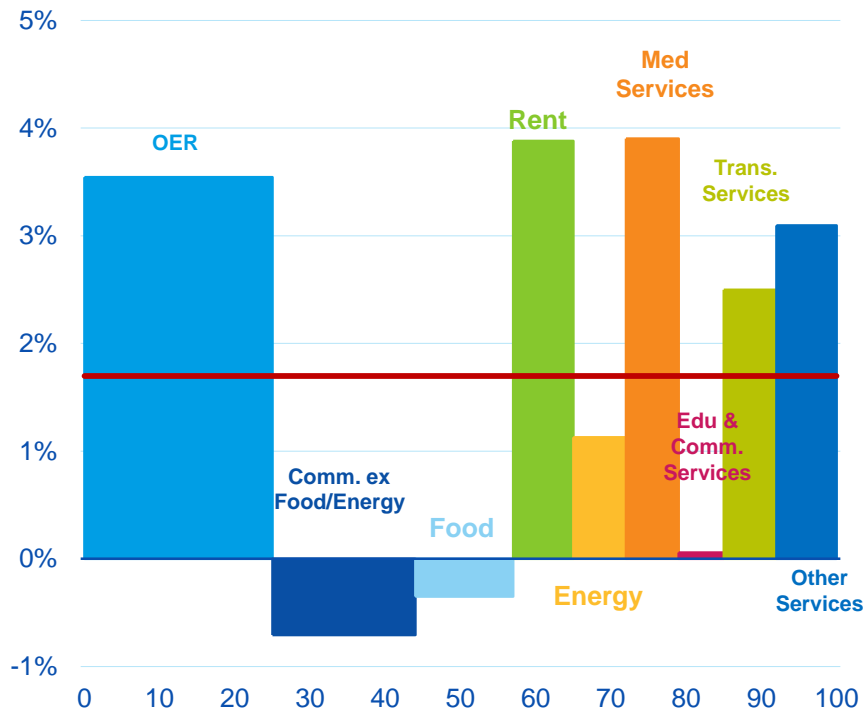


# Inflation

Inflation pressures building with rising energy prices, tightening labor market and expectations of fiscal expansion

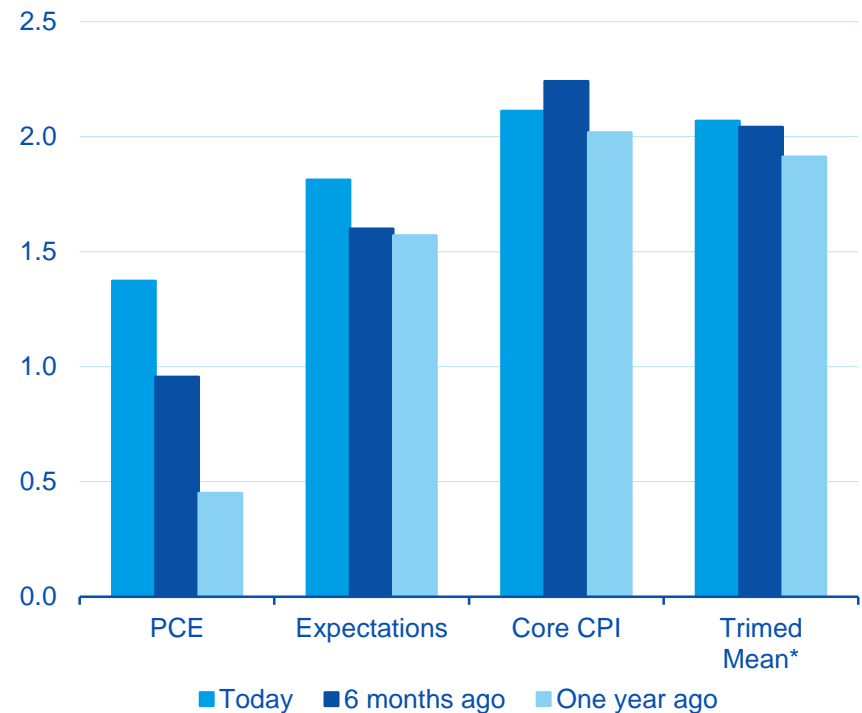
## Contribution to CPI

Relative importance & 12-month % change



## Consumer Inflation

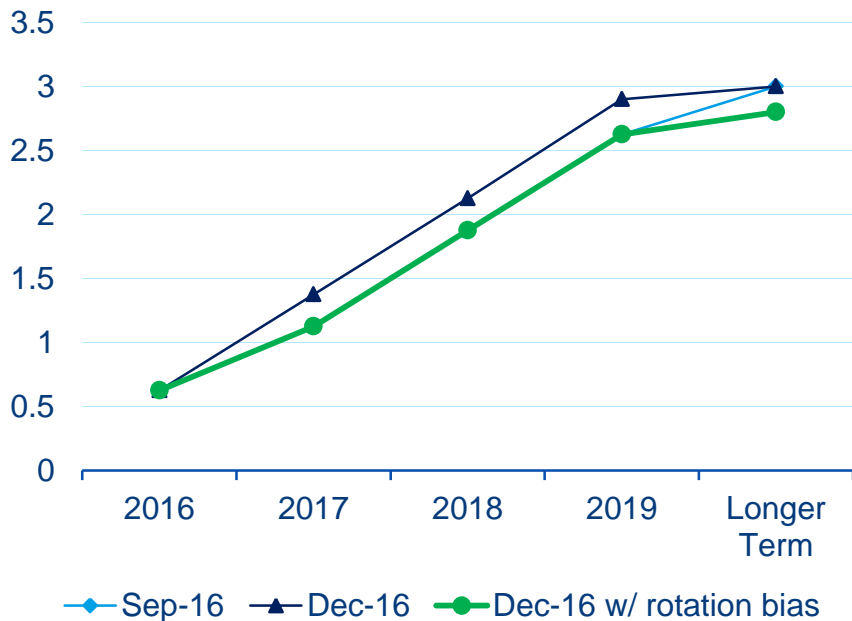
Year-over-year %



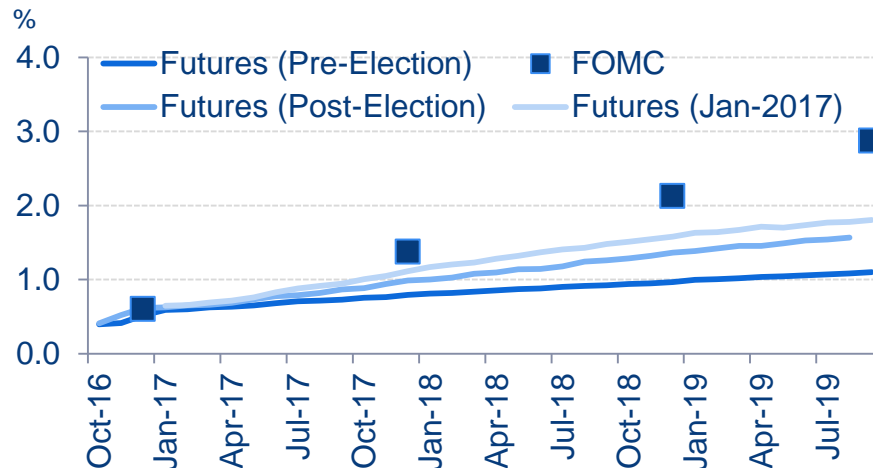
# Fed next move in June

Rotation of voting members implies a slightly more dovish FOMC. Expecting Fed to maintain its gradual tightening pace

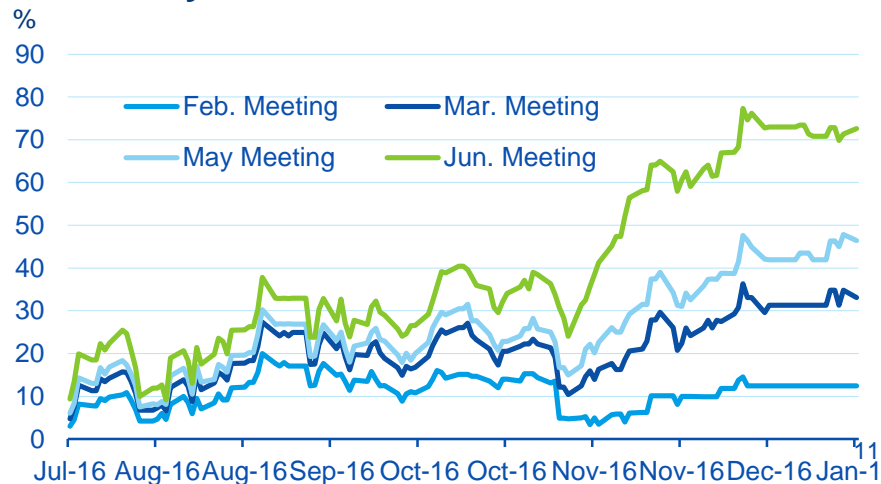
**FOMC Appropriate pace of policy firming**  
Median %, last release



**Fed Funds: FOMC vs. Futures Curve**



**Probability of at Least One Rate Hike**

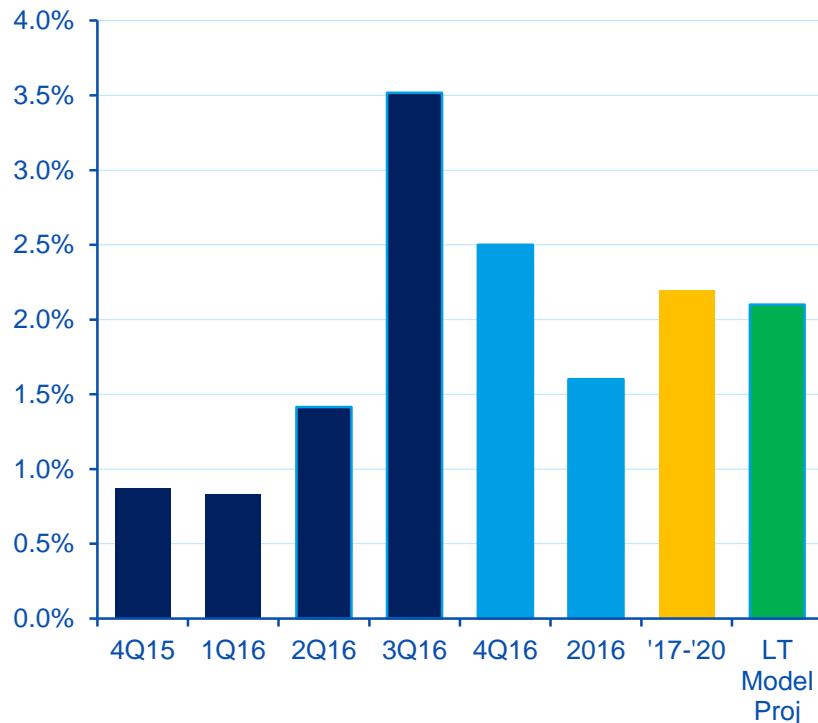


# U.S. Outlook

## Growth to recover to moderate pace in 2017

### U.S. GDP Growth

%



- Pressures from weak investment fading
  - Upturn in Oil & Gas
- Despite labor market deceleration, consumption to hold steady
- Strong dollar to weigh on exports
- Fed gradual tightening cycle to generate headwinds
- Near term risks include weak global demand, political instability in Europe, disorderly correction in China, emerging market vulnerabilities (Mexico)

# Uncertainties in Trump presidency

Broad-based change, entitlement reform and fiscal conservatism?

## Infrastructure

- \$1tn over 10 years
- Revenue neutral?
- Appetite for private-public partnerships?

## Tax

- Impact of tax cuts on marginal propensity to consume?
- Tax break for investors willing to lend to state and local
- Border tax, 10% tax on retained foreign earnings, tariffs?

## Trade

- Reassess NAFTA; symbolic or withdrawal?
- China's currency policy; hard or soft stance?
- Kill TPP and make TTIP more difficult

## Immigration

- Repeal Obama's executive orders
- Focus on border security; virtual or physical wall?
- Mass deportations?

## Deregulation

- Repeal ACA; replace it with what?
- EPA, Dodd-Frank, FCC, DOL
- Streamlined and simplified regulations?

## Who is Trump?

- Face Value?
- Traditional Republican?
- Populist?
- Disruptor?
- Twitterer-in-chief?

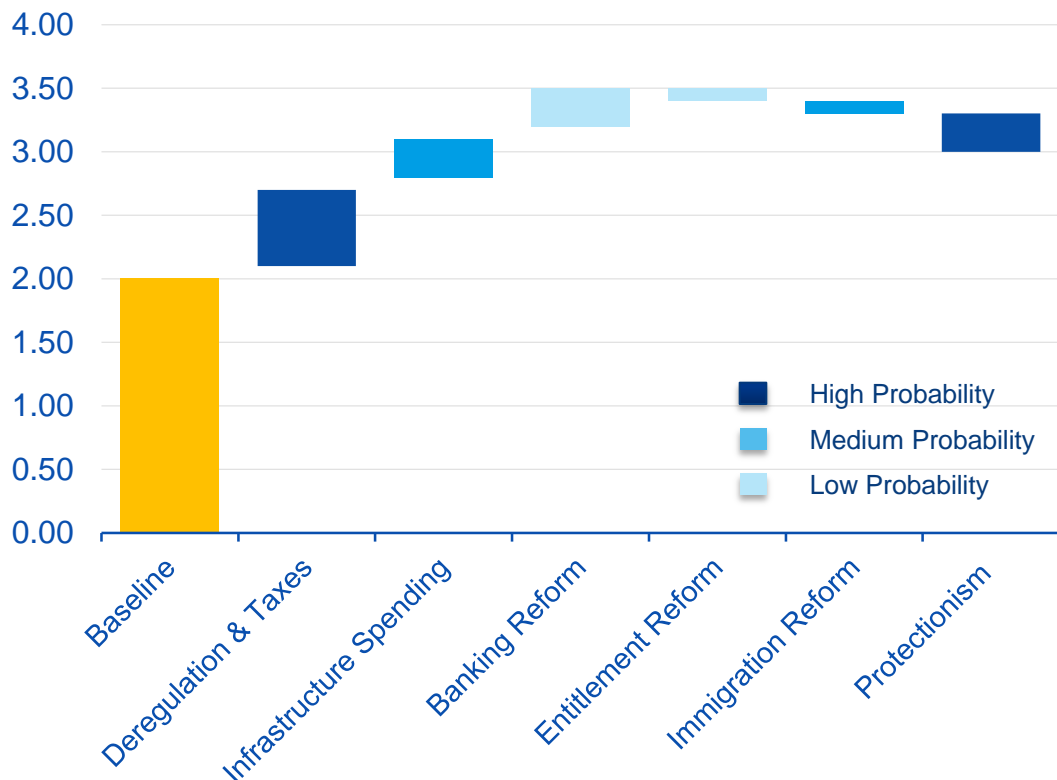


# Uncertainties: Trumponomics

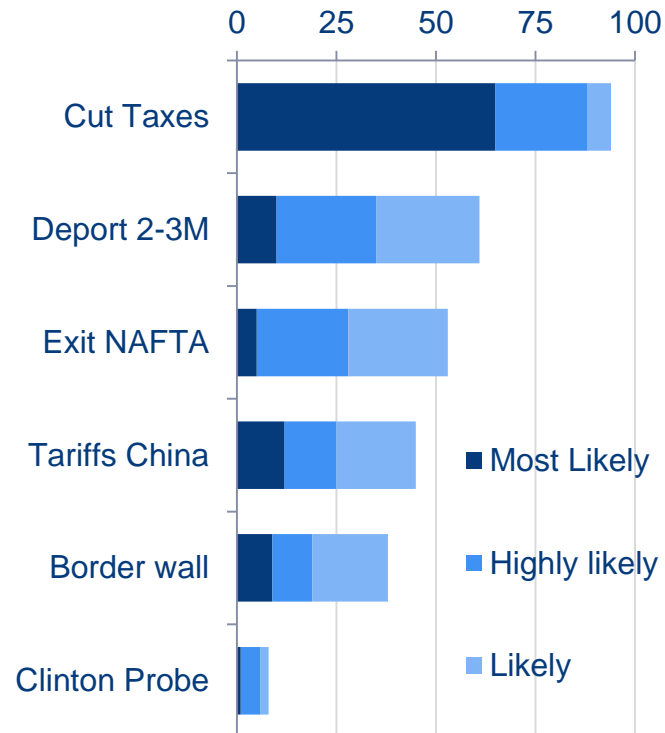
Magnitude, mix and timing of policy initiatives uncertain, but current proposals imply stronger growth

**Potential Impact from Trump Policy Proposals**

Central tendency, %

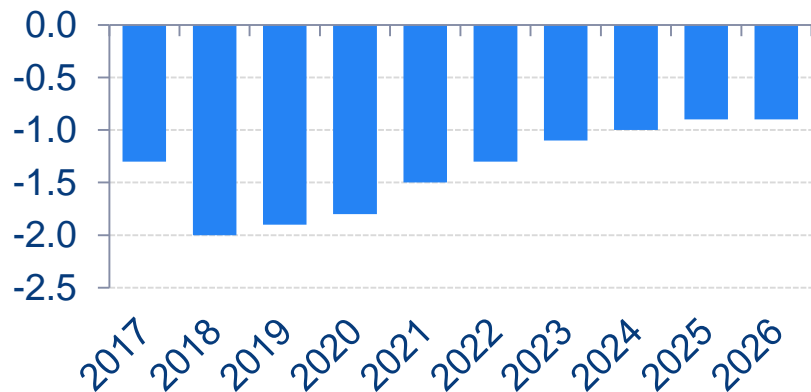


**Survey: Trump most likely actions**

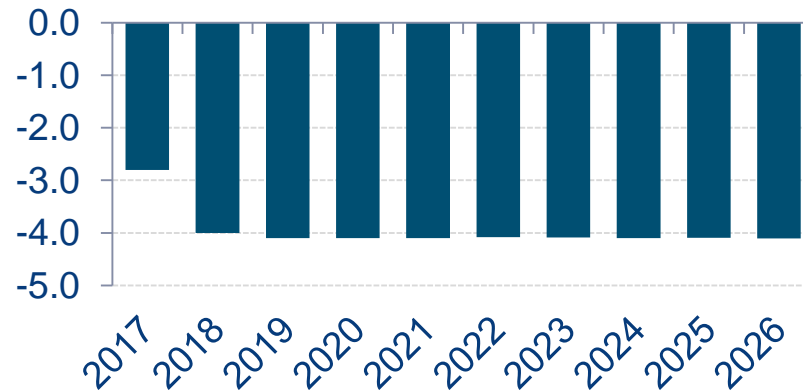


# Uncertainties: fiscal policy

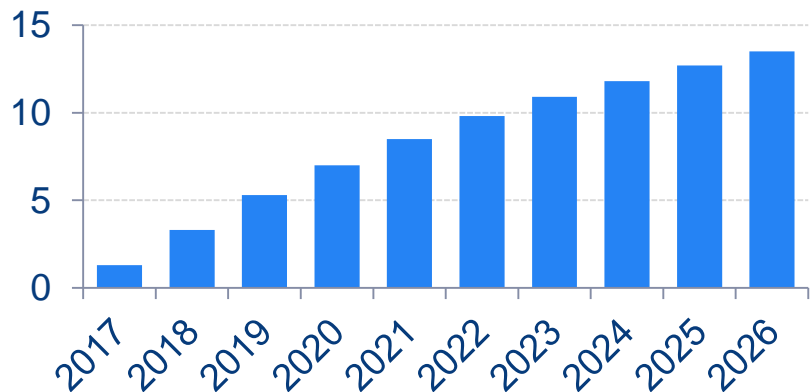
**GOP Plan: Annual Revenue Loss (% GDP)**



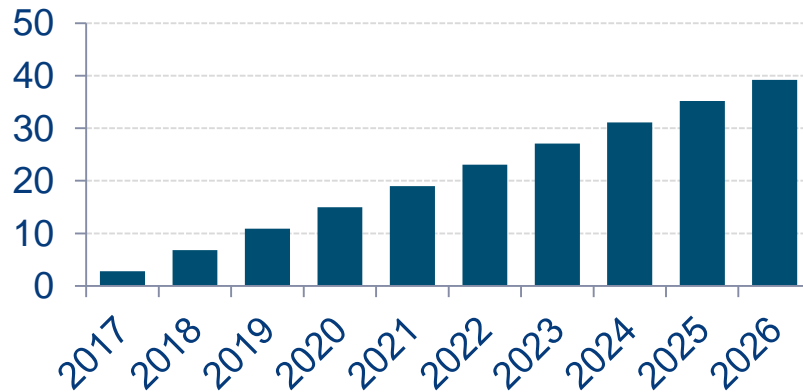
**Trump Plan: Annual Revenue Loss (% GDP)**



**GOP Plan: Cumulative Debt Increase (% GDP)**



**Trump Plan: Cumulative Debt Increase (% GDP)**

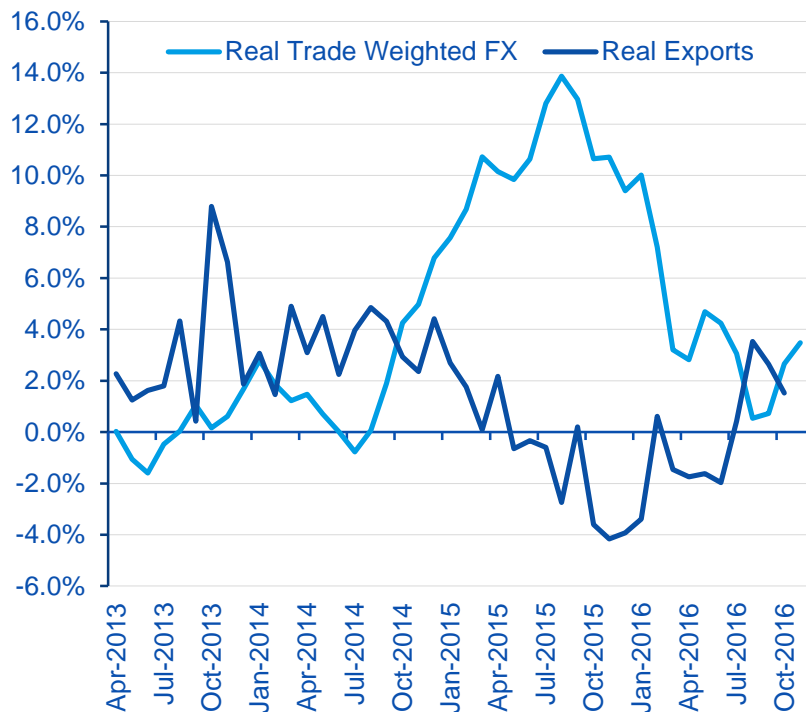


# Uncertainties: FX and inflation

Fluctuations in the dollar could counterbalance Trump policies

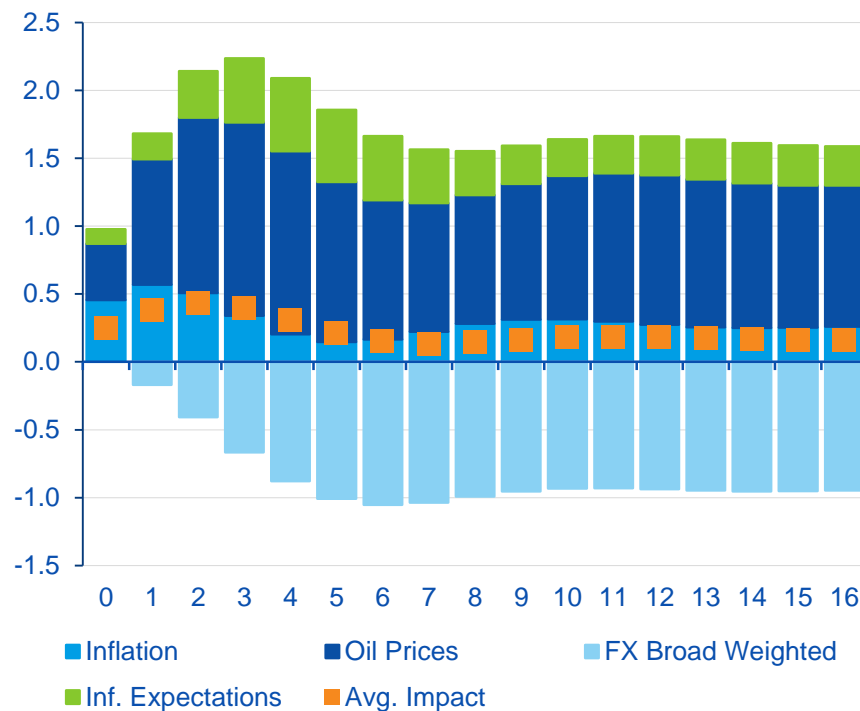
## Real Exchange Rates & Exports

YoY % change



## Headline CPI Impulse Response Functions

%

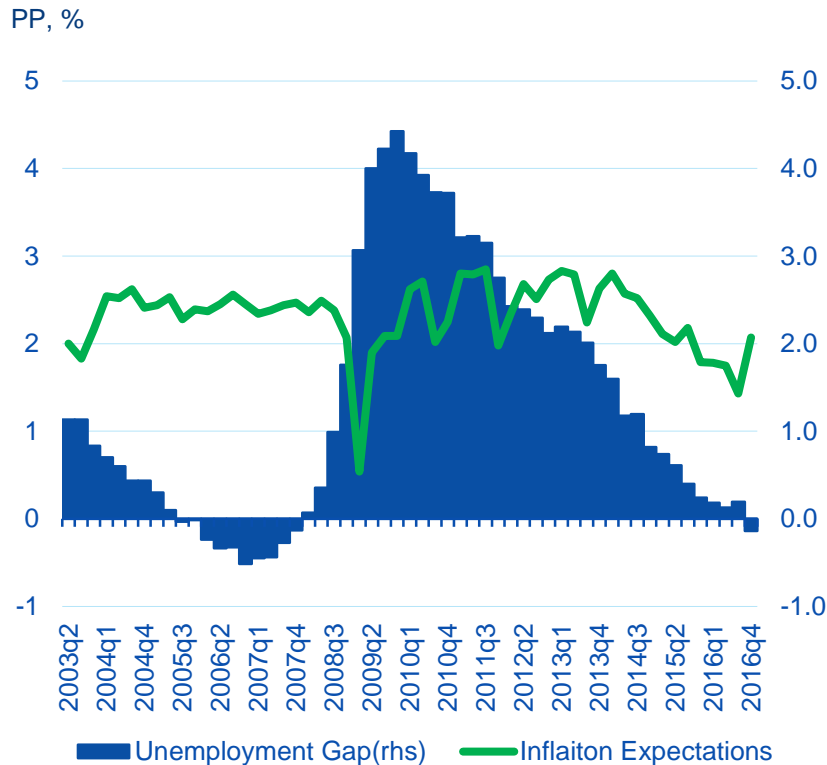




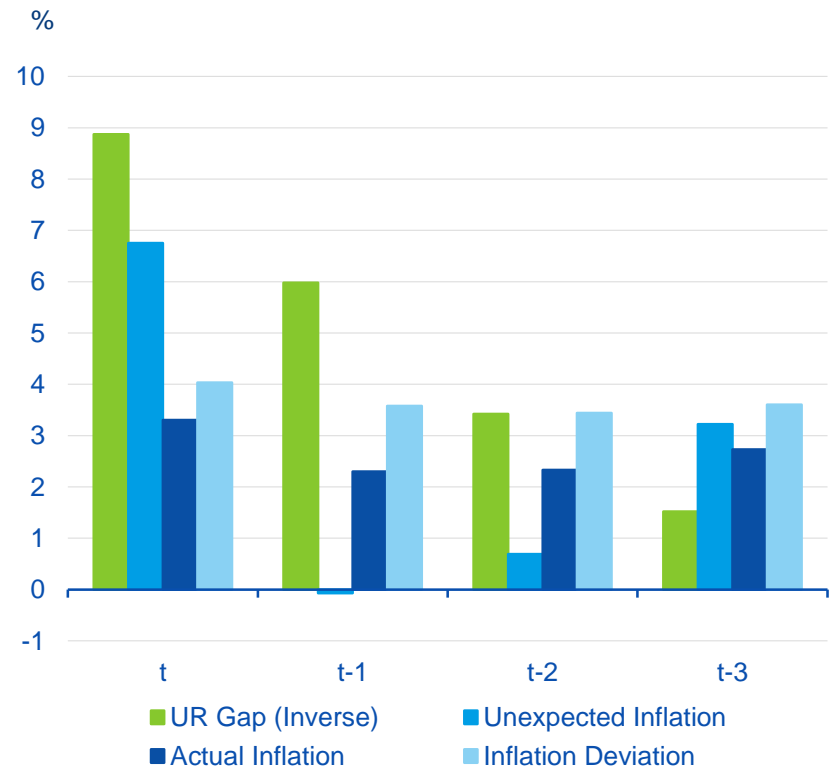
# Uncertainties: monetary policy

Implied impact of Trump policies suggest Fed will continue on it gradual tightening path; unexpected inflation could speed up process

**Unemployment Gap and Inflation Expectations**

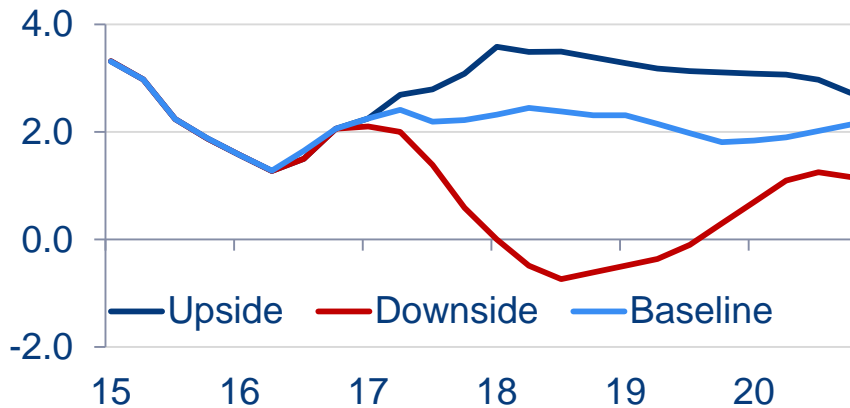


**Marginal Probability of Fed Rate Increase**

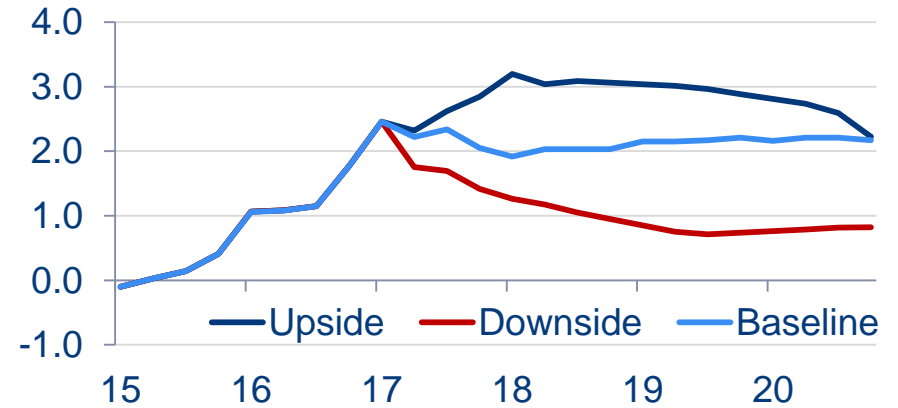


# Scenarios

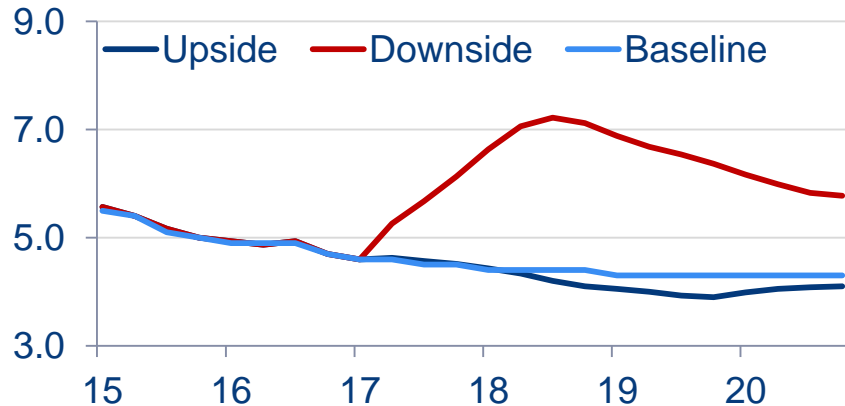
**Real GDP, YoY % Change**



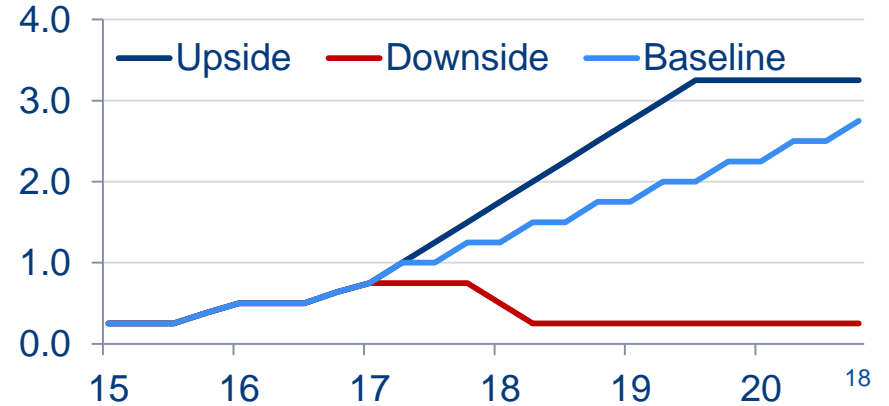
**CPI, YoY % Change**



**Unemployment Rate, %**



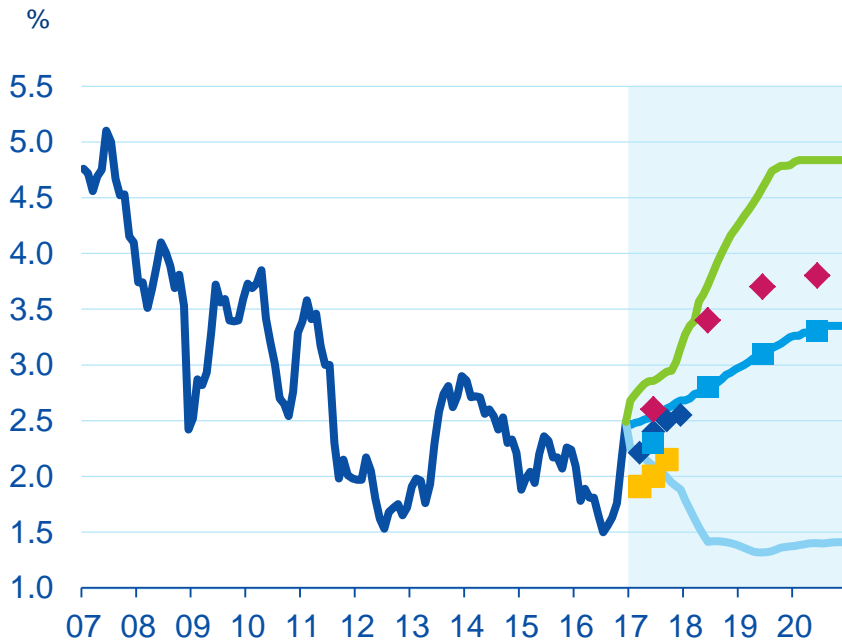
**Fed Funds, %**



# Treasury yields

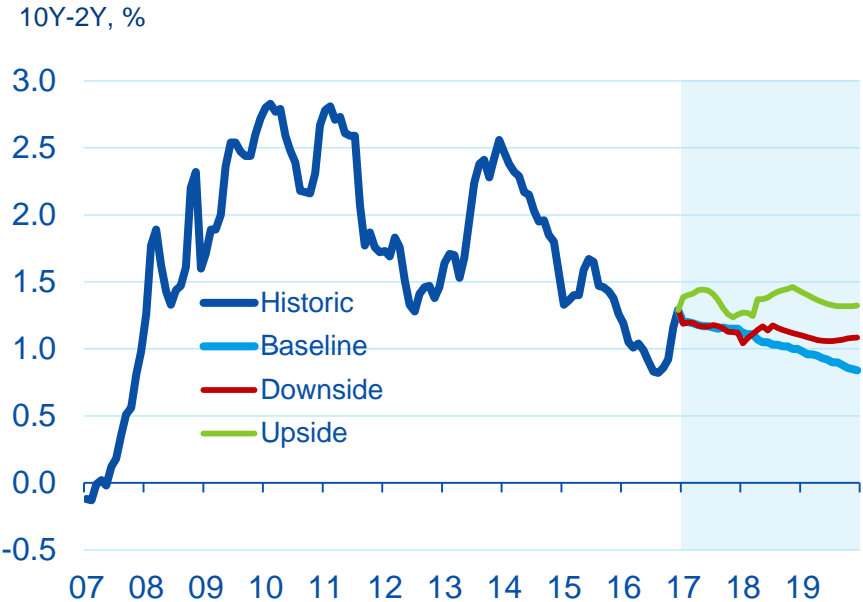
Stronger growth and inflation expectations, and greater risk appetite will push yields higher

10-Year Treasury Yield Forecast



- Historic
- Baseline
- Downside
- Upside
- SPF (EOP, Nov 14)
- CBO (Yr. Avg, Dec 1)
- ◆ NABE (EOP, Dec 4)
- ◆ Blue Chip (Jul 19)

Treasury Yield Curve Slope

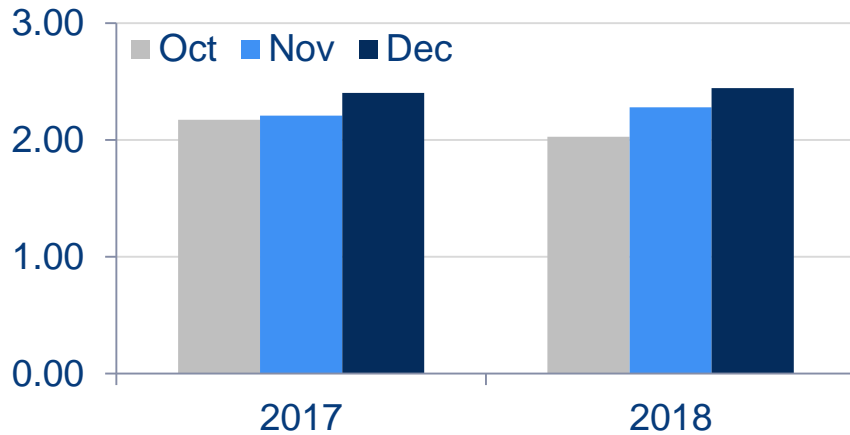


Scenarios		2016	2017	2018	2019	2020
Baseline	60%	2.5	2.68	2.96	3.25	3.35
Upside	25%		3.15	4.22	4.79	4.84
Downside	15%		1.88	1.39	1.37	1.41

# Survey: post-election expectations

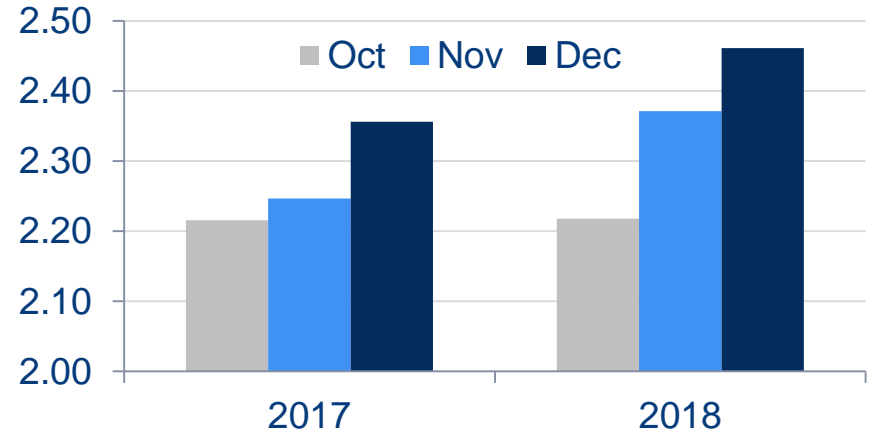
## Real GDP

4Q/4Q, %



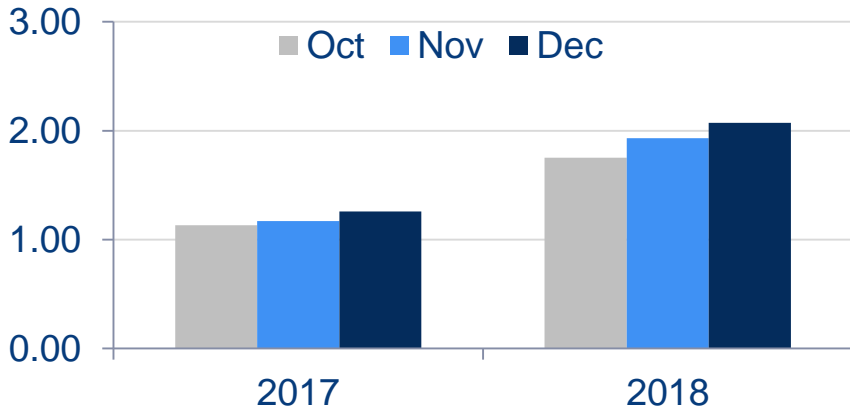
## CPI

%



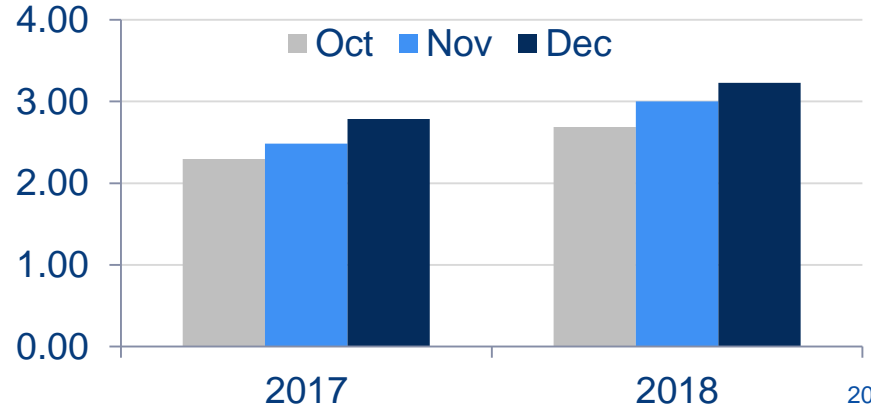
## Fed

EOP, %



## 10YTN

EOP, %

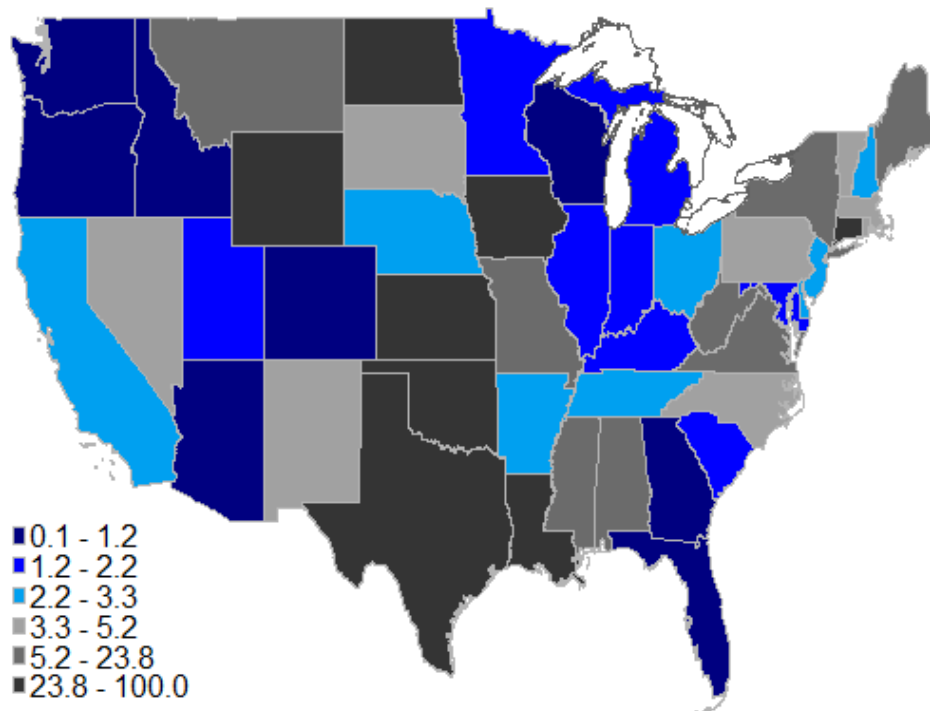


# Recession risks fading

Only handful of energy-dependent areas remain in recession

## State-level Recession Probability

Probability of being in recession within 12-months, %



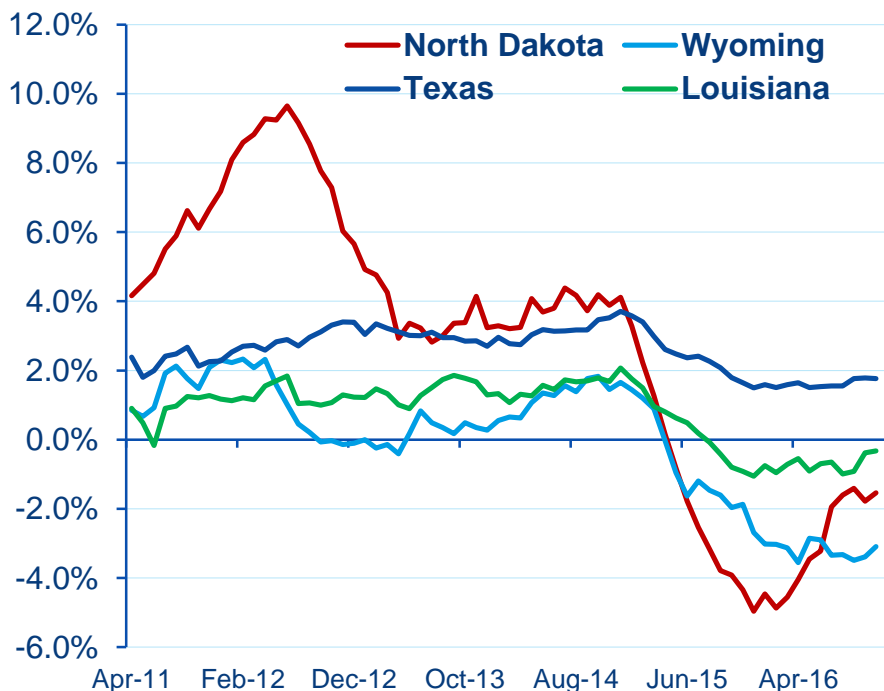
- 2016 growth mirrored 1986 decoupling, acutely impacting commodity producing states
  - Texas probability of recession ~60% (3Q16)
- Fading pressures on the dollar and stronger global growth lowers risk to manufacturers
- Including mining intensive states, the probability of recession remains below average (13%)
- Consumer-driven economies stand to benefit
  - Florida: 0%
  - Colorado: 0%
  - California: 3%

# Texas: why this time was different

- Relative exposure low
- Dependency nearly half as large as '80s
- Risks contained in Major MSAs

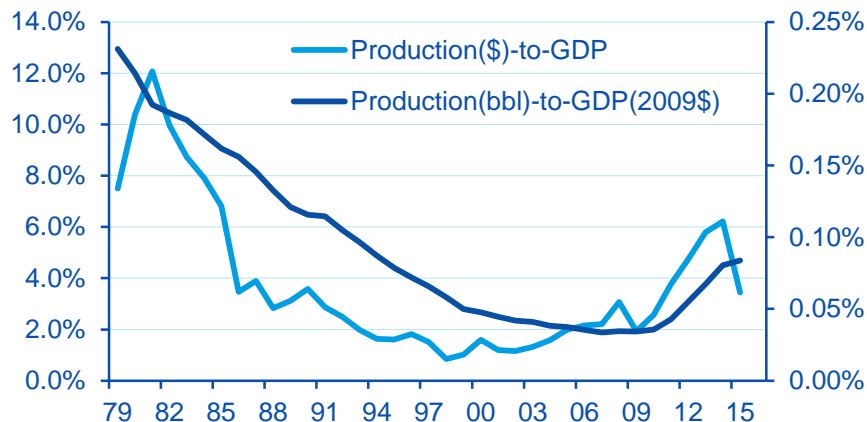
## Employment Growth

Year-over-year %



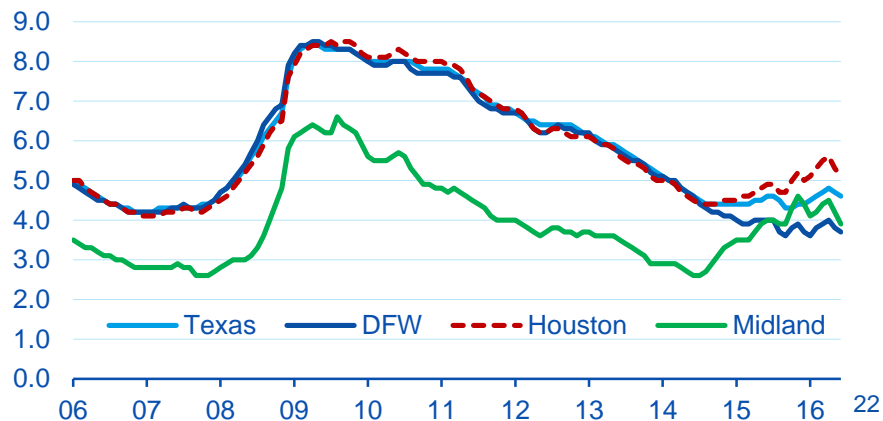
## Production and GDP

%



## Unemployment Rate

%



# Oil price forecasts

## Upward revision to 2017 and 2018

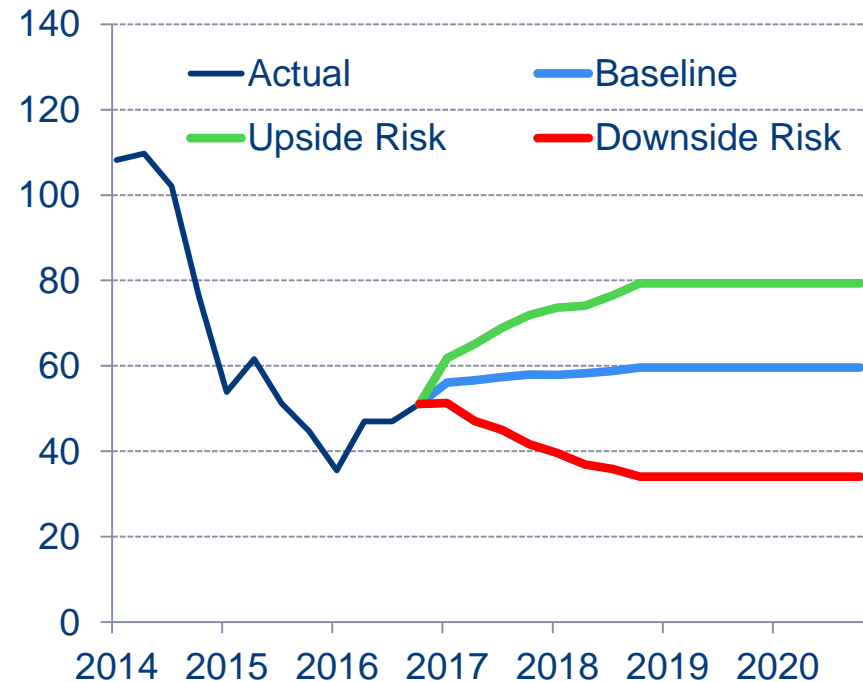
### Crude oil price forecasts\*

Brent, \$ per barrel, avg.

	Baseline	Upside	Downside
2015	52.8	52.8	52.8
2016	45.2	45.2	45.2
2017	<b>57.0</b>	<b>66.9</b>	<b>46.2</b>
2018	<b>58.7</b>	<b>75.8</b>	<b>36.6</b>
2019	59.6	79.3	34.1
2020	59.6	79.3	34.1

### Crude oil price forecasts\*

Brent, \$ per barrel, avg.



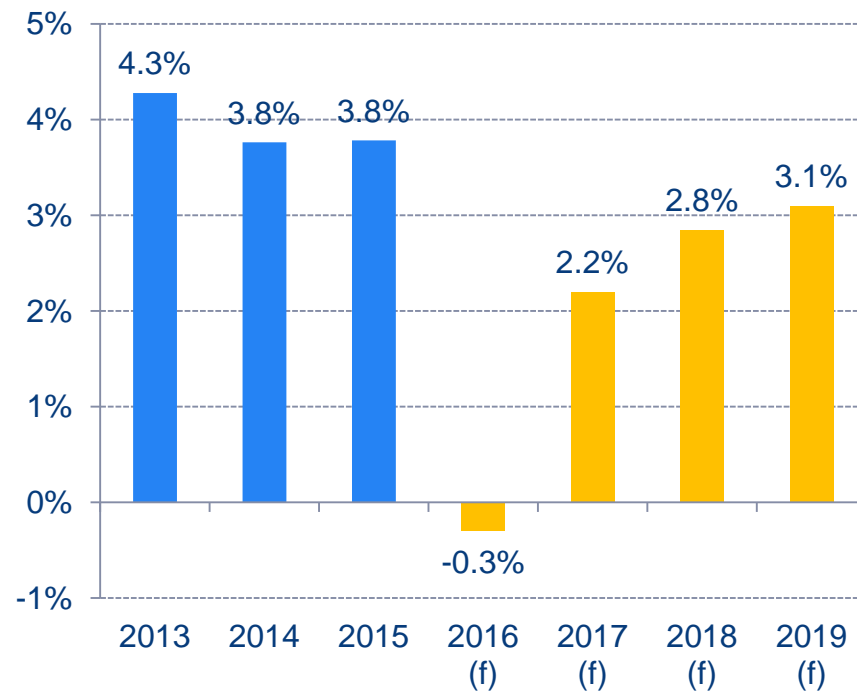
\*Forecast subject to change.  
Source: BBVA Research & Haver Analytics

# Texas Outlook

Risk balance tilting to the upside for Texas

## Texas GDP Growth

(Chained \$2009)



Source: BBVA Research

- Maintain 2016 baseline
  - -0.3% growth
  - Downsides risks realized in current oil price environment
- Baseline is for return to positive growth in '17
- Oil-dependent MSAs resilient in the face of slumping oil prices
- Steady gains in oil prices will accelerate the recovery
- Current reversal in oil price gains, border adjustment, balance sheet pressures on O&G firms, dollar strengthening, increased trade barriers, emigration

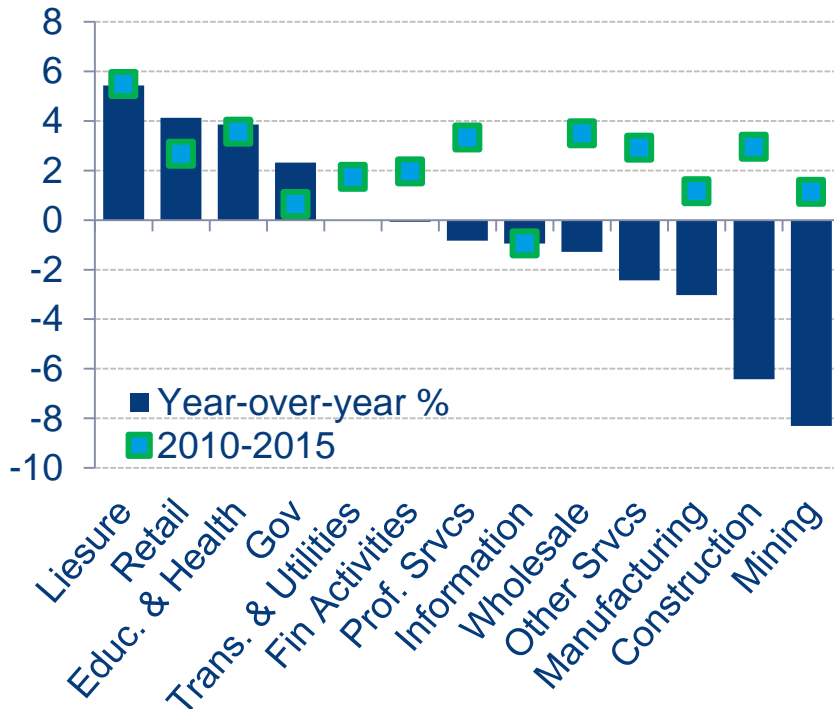


# Houston Economy

Pressures on mining and manufacturing sectors slowing, but 2<sup>nd</sup> round effects materializing

## Industry Employment Growth

Change, annualized %



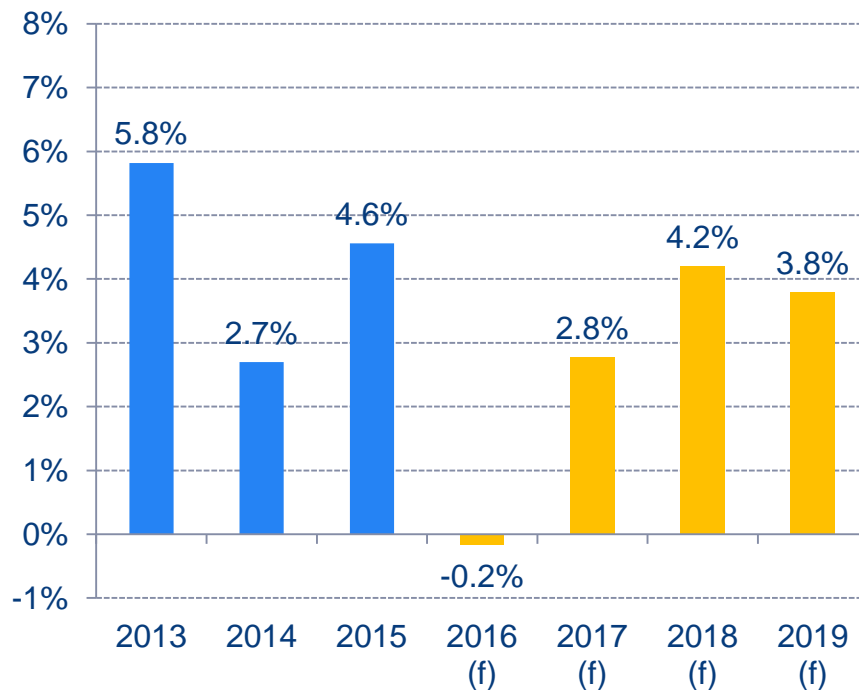
- Houston annual pace of job creation at 16K
  - Down from 120K in Dec. 2014
- Houston UR above the U.S. average for first time since 2006 (5.1%)
- Job losses primarily in goods producing sectors slowing
- Home prices continue to decelerate

# Houston Outlook

Houston, we've found a bottom

## Houston GDP Growth

(Chained \$2009)



Source: BBVA Research

- Petrochemicals helping to offset pressures on upstream activity
- Bottom realized in 3Q16
  - 2016: -0.2% growth
- Like Texas, growth to return in '17
- Long-run potential still high (~3-4%)
- Longer-run opportunities remain, as city is one of the most attract in country despite exposure to commodity cycles
- Reorienting to business services, healthcare and leisure will quicken pace of recovery
- Risks include high emigration rates due to consolidation in O&G sector, additional oil shocks and pressures on healthcare from increased regulation

# Post-Election Scenarios

Post-election probability distribution implies fatter tails

Macro Scenarios*								
	2013	2014	2015	2016	2017	2018	2019	2020
GDP	1.7	2.4	2.6	1.6	2.3	2.4	2.1	2.0
Upside	1.7	2.4	2.6	1.6	2.7	3.5	3.2	3.0
Downside	1.7	2.4	2.6	1.6	1.5	-0.5	-0.2	1.1
UR	7.4	6.2	5.3	4.8	4.5	4.4	4.3	4.3
Upside	7.4	6.2	5.3	4.9	4.6	4.3	4	4.1
Downside	7.4	6.2	5.3	4.9	5.4	7	6.6	5.9
CPI	1.5	1.6	0.1	1.2	2.3	2.0	2.2	2.2
Upside	1.5	1.6	0.1	1.2	2.6	3.1	3	2.6
Downside	1.5	1.6	0.1	1.2	1.9	1.1	0.8	0.8
Fed[eop]	0.25	0.25	0.50	0.75	1.25	1.75	2.25	2.75
Upside	0.25	0.25	0.50	0.75	1.50	2.5	3.25	3.25
Downside	0.25	0.25	0.50	0.75	0.75	0.25	0.25	0.25
10-Yr [eop]	2.9	2.2	2.2	2.5	2.7	3.0	3.3	3.4
Upside	2.9	2.2	2.2	2.5	3.2	4.2	4.8	4.8
Downside	2.9	2.2	2.2	2.5	1.9	1.4	1.4	1.4

\*Subject to revision

# Outlook & forecasts

	2011	2012	2013	2014	2015	2016	2017	2018	2019	2020
<b>Real GDP (% SAAR)</b>	1.6	2.2	1.7	2.4	2.6	1.6	2.3	2.4	2.1	2.0
<b>Real GDP (Contribution, pp)</b>										
<b>PCE</b>	1.6	1.0	1.0	2.0	2.2	1.8	1.7	1.5	1.5	1.5
<b>Gross Investment</b>	0.7	1.5	1.0	0.7	0.8	-0.4	0.4	1.0	0.8	0.6
<b>Non Residential</b>	0.9	1.1	0.4	0.8	0.3	-0.1	0.4	0.8	0.7	0.4
<b>Residential</b>	0.0	0.3	0.3	0.1	0.4	0.1	0.1	0.2	0.2	0.2
<b>Exports</b>	0.9	0.5	0.5	0.6	0.0	0.1	0.4	0.5	0.6	0.7
<b>Imports</b>	-0.9	-0.4	-0.2	-0.7	-0.7	0.1	0.6	0.8	0.8	0.8
<b>Government</b>	-0.7	-0.4	-0.6	-0.2	0.3	0.2	0.2	0.2	0.0	-0.1
<b>Unemployment Rate (% , average)</b>	8.9	8.1	7.4	6.2	5.3	4.9	4.6	4.4	4.4	4.3
<b>Avg. Monthly Nonfarm Payroll (K)</b>	167	177	200	236	231	185	166	166	208	211
<b>CPI (YoY %)</b>	3.1	2.1	1.5	1.6	0.1	1.3	2.2	2.0	2.1	2.1
<b>Core CPI (YoY %)</b>	1.7	2.1	1.8	1.7	1.8	2.2	1.9	2.2	2.3	2.5
<b>Fiscal Balance (% GDP)</b>	-8.7	-6.8	-4.1	-2.8	-2.5	-3.0	-3.0	-2.9	-3.1	-3.3
<b>Current Account (bop, % GDP)</b>	-3.0	-2.8	-2.2	-2.8	-2.4	-2.8	-3.0	-3.1	-3.1	-3.2
<b>Fed Target Rate (% , eop)</b>	0.25	0.25	0.25	0.25	0.38	0.64	1.25	1.75	2.25	2.75
<b>Core Logic National HPI (YoY %)</b>	-2.9	4.0	9.9	6.9	5.4	5.6	5.9	4.1	4.4	4.1
<b>10-Yr Treasury (% Yield, eop)</b>	1.98	1.72	2.90	2.21	2.24	2.49	2.68	2.96	3.25	3.35
<b>Brent Oil Prices (dps, average)</b>	94.9	94.1	97.9	93.3	48.7	43.3	54.8	56.4	57.1	57.1

# MITEF Forecasters Luncheon

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